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October 23, 2002

BY E-MAIL

Canadian Securities Administrators
c/o Ms. Denise Brosseau
Secretary
Commission des valeurs mobilières du Québec
800 Victoria Square, Stock Exchange Tower
P.O. Box 246, 22nd Floor
Montréal, Québec
H4Z 1G3

Dear Sirs/Mesdames:

Re: Proposed Amendments to NI 81-102 – *Mutual Funds* relating to Fund of Funds Structures

We welcome the opportunity to provide our comments to the Canadian Securities Administrators (the "**CSA**") on the proposed amendments to National Instrument 81-102 – *Mutual Funds* ("**NI 81-102**") relating to the regulatory framework for fund of funds structures (the "**Fund of Funds Amendments**").

Our comments on the issues in respect of which the CSA has sought comment in the Fund of Funds Amendments are set out below:

Issue 1. Qualification of the bottom fund in the local jurisdiction

We believe that a top fund should be able to invest in a bottom fund as long as the bottom fund is qualified in any of the local jurisdictions in Canada. We believe that the regulation of mutual funds in Canada is now sufficiently harmonized that to allow such investments would not be contrary to the public interest. In the event the regulator in a local jurisdiction wishes to exercise jurisdiction over or sanction a bottom fund or bottom fund manager not qualified or registered in the local jurisdiction, the regulator should be able to liaise and co-operate with the out-of-province regulator of the bottom fund or bottom fund manager to ensure proper compliance with applicable securities legislation.

Issue 2. Investments in funds other than those to which NI 81-101 and NI 81-102 apply

We believe that investment options for a top fund should be expanded to include other types of mutual funds and investment funds such as pooled funds or commodity pools. If such investment options constitute "illiquid assets" as such term is defined in NI 81-102, then they should be treated as such and be subject to section 2.4 of NI 81-102.

Issue 3. Requirement to be a Top Fund and removing the existing 10% investment provision in section 2.5 of NI 81-102

If the definition of "top fund" requires that a fund have a fundamental investment objective allowing it to invest in bottom funds or RSP clone funds, we believe that mutual funds will, as a matter of course, and in many cases for purposes of flexibility only, include investing in other mutual funds in their fundamental investment objectives. We question the utility of such result. We prefer the existing regime which allows a mutual fund to invest at least a portion of its assets in other mutual funds without having to include such investment strategy in its fundamental investment objectives. We believe that the existing 10% limit is a reasonable limit in this regard.

We agree with the view expressed by others that if the final form of the Fund of Funds Amendments requires top funds to have a fundamental investment objective allowing them to invest in bottom funds, then transitional provisions should be included in the Fund of Funds Amendments to allow existing top funds to amend their investment objectives to such effect without having to hold costly securityholder meetings to consider and vote on such amendments.

Issue 4. Control of the bottom fund by the top fund

(i) Removal of the concentration and control restrictions

If a top fund is to be allowed to actively manage its fund-of-fund investments, then we believe that there should be no restrictions on the amount that a top fund can invest in a Bottom Fund. The key consideration in allowing a top fund's manager/portfolio advisor to make a fund-of-fund investment is whether or not such an investment is consistent with the top fund's investment objective. The CSA, including the securityholders of the top fund, should be able to rely on the top fund manager's/portfolio advisor's standard of care as it decides the amount which a top fund will invest in or hold of a bottom fund.

(ii) Massive redemption

In our experience, the necessity in certain circumstances under the current regulatory regime for a bottom fund to effect a large redemption in a short time frame can raise

serious portfolio management issues for the bottom fund and its securityholders. This situation will be exacerbated under the Fund of Funds Amendments which will allow up to 100% ownership of a bottom fund by a top fund. Accordingly, we believe that restrictions should be imposed on the top fund to ensure that the bottom fund has sufficient time to sell its assets and to pay the top fund, all in an orderly manner. Those restrictions could be stated in a general fashion; that is, by way of a statement of regulatory principle to the effect that bottom funds shall be permitted to sell assets in order to respond to large redemption requests in an orderly manner that is in the best interests of the securityholders of the bottom fund.

Issue 5. Prohibition against Sales and Redemption Charges

We believe that the policy concerns underlying the prohibition on the payment of fees within a fund of funds structure are much greater in circumstances where the top fund and the bottom fund are under common management. Where the payment of fees in a fund of funds structure has been negotiated between parties operating at arm's length and the nature and amount of those fees is fully disclosed in the prospectus, we believe the related policy concerns are much reduced. If there are residual concerns with the payment of fees in such circumstances, it may be appropriate to have such fees be subject to ongoing review by the fund groups' governance agencies.

Issue 6. Voting rights of top fund securityholders in bottom fund matters

We agree that the top fund's manager should be responsible for exercising bottom fund voting rights and that these no longer should be passed through to securityholders of the top fund. However, we are concerned that precluding a manager of a top fund from voting securities of a bottom fund under common management may be problematic if all of the units of the bottom fund are owned by top funds with a common manager. In addition, if the top fund represents a significant percentage of the securityholders of the bottom fund and is not permitted to participate in votes on fundamental matters, the top fund's only recourse in such circumstances in the event of an adverse change in the bottom fund may be a complete redemption of its investment in the bottom fund. Such a massive redemption could be detrimental to securityholders of both the top and bottom fund. Again, perhaps the proposed fund governance agency could be consulted in respect of voting matters where there is a conflict of interest between top and bottom funds.

Issue 7. Active management and prospectus disclosure

The "active" management of fund of funds investments necessarily will involve disclosure of the fact that investments by top funds in bottom funds will be adjusted, in whole or in part, from time to time. We believe that such disclosure should be sufficient for investors so that in circumstances where a top fund replaces its holding in one "important" bottom fund, for another bottom fund, it would not be necessary for

investors to specifically be notified of such change. We note in this regard that if such a change is made and it is determined to constitute a "significant change" for the top fund, then the top fund will be obliged to comply with the timely disclosure requirements of NI 81-102. Top funds should, however, in any event be obliged to maintain "top ten" holdings lists which are readily accessible to investors via toll-free telephone numbers or web sites.

Other comments

Notwithstanding that existing exemptive relief for fund of funds products typically has a "sunset" condition, we wonder whether, at this juncture and given the relatively lengthy period of time during which certain fund of fund products have been in existence, it is fair to require the promoters of those products to revise the structure thereof so as to comply with the Fund of Funds Amendments. We believe it might be more appropriate to grandfather those products from the application of the Amendments, or to allow them exemptions therefrom on conditions to be negotiated.

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Thank you for providing the opportunity for us to deliver our comments to the CSA on the Fund of Funds Amendments. If you have any questions or wish to discuss any aspect of our comments, please contact David Moritsugu, Garth Foster or Tracy Hooey, all of whom are at our Toronto office.

Yours truly,

FASKEN MARTINEAU DuMOULIN LLP

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